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QUESTION. Are the Dow-Jones averages still an accurate measure of the market?

ANSWER. Much is written these days of the distortion in the D-J averages. Critics, for the most part ignorant of their use, point to the fact that had I.B.M. not been removed from the D-J industrial list some years ago, that average would not be over 1500. My answer to this is, what of it? The rails would still have to confirm for a bullish signal, regardless of the advance in the industrial average. We do not buy merely because one average is high or advancing; we buy when the trend of the averages is relatively clear, and when both indicators are plotting a bullish course together.

The purpose of the D-J averages has always been to measure the market; the stocks used in the averages were meant to be representative of the economy as a whole. When an individual security, because of its explosive action, becomes atypical of the market it is rightfully removed. We do not need to measure a few spectacular issues; what we do require is an accurate gauge which represents a true average of the entire market. Perhaps a valid criticism of the D-J industrials is that it contains no missile, instrument, or aluminum stocks. Very possibly this will be corrected in the near future.

QUESTION. Why do Dow Theorists ignore intra-day highs and lows in the averages?

ANSWER. The Dow Theory uses only the daily closing prices of the D-J industrial and rail averages. The reason for this is that, theoretically, a trader or group of traders could manipulate the price of a security or even the averages on an intra-day basis. One stock or a few stocks could be carefully purchased and re-purchased, and in this way advanced in price through the use of the same fixed amount of capital. In fact, many traders and specialists will take a large position in a stock until, say, 3:00 P.M. on a trading day. It is common practice, however, for floor members to "clean house" before the closing bell, and for this reason prices are not considered final until the last tick is registered at the end of the day. These closing prices, taken after the intra-day positions are cleaned out, are the quotes which Dow Theorists believe are significant.

Most people do not realize that the daily highs and lows in the averages represent only theoretical points. The highs, for instance, are calculated by recording the high of each stock in the averages during a given day, regardless of when these highs were attained, and these figures are then compounded into a fictional daily "high." There is no minute or hour during the day when this "high" was actually hit, and as far as this writer is concerned the daily highs and lows represent utterly useless and even deceptive figures.

INVESTMENT POLICY. These Letters were inaugurated with the express purpose of teaching the principles of the Dow Theory as an aid to portfolio and money management. This implies, among other things, learning to recognize and invest with the trend of stocks and the economy. Rhea put it more strongly when he wrote: "I know of no man who has prospered in stock trading over a long period of time who does not, consciously or unconsciously, follow Dow's tenets." By the same token, this writer knows few if any individuals who have consistently made money in the market on the "tips" and advice of others. I do not and cannot write these Letters in typical investment advisory service fashion. Before coming upon Dow's Theory I sustained many losses by following what was purported to be the best professional advice available. Since then I have reached one unfailing conclusion: that the man who will not take the trouble to master the fundamentals of the price movements will not make money in stocks over the long run. If subscribers cannot profit by the information in these Letters, it is probably because I lack skill as a writer or analyst, or because the

individual investor has allowed his wishes and preconceived opinions to dictate his market policy while ignoring the lessons of the Dow Theory.

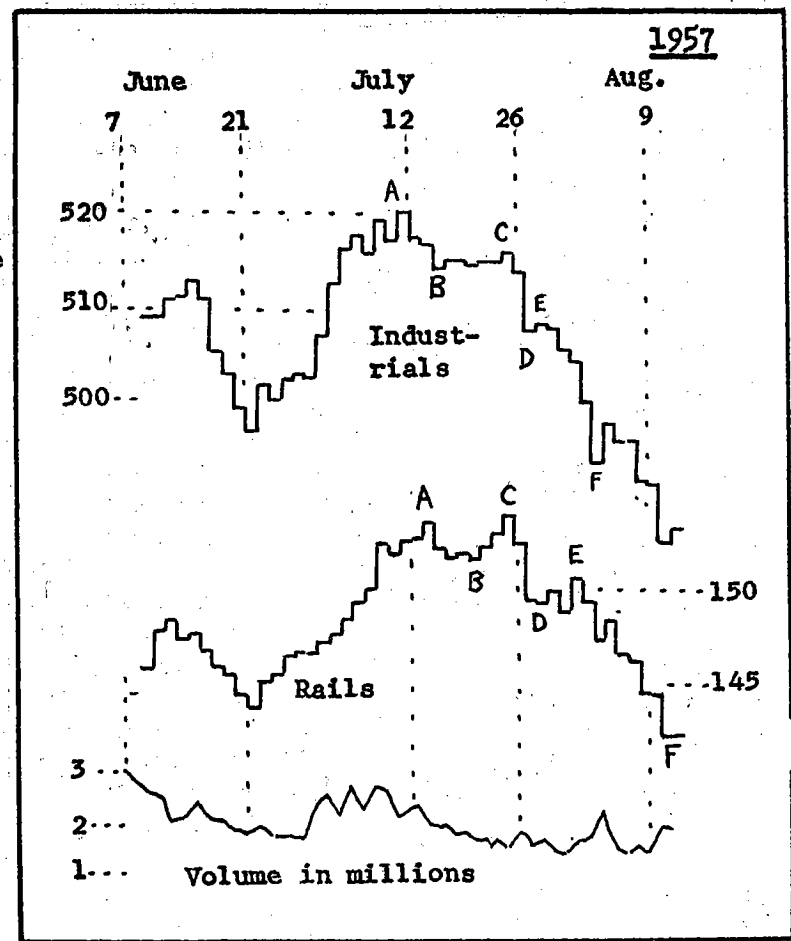
Many readers of these letters have held their stocks since 1942 or even before; others hold securities which they purchased in 1949-50 when the present primary bull trend first turned up. But each day I receive letters from new subscribers who are either completely uninvested, only partially invested, or "locked-in" with securities which on average show substantial losses.

There is no questioning the fact that all stocks do not advance or decline together. I am looking at letters from three people whose entire portfolios yield net losses sustained in the last few months. However, it seems to me that these investors could not have timed their purchases properly if they show no profits through what has been the second greatest primary bull swing in all history. Charles H. Dow observed that "Stocks tend to fluctuate together." In proof of this it is interesting to note that during the year 1958, of the 1,071 issues listed on the N.Y. Stock Exchange, all but 26 were higher at the close of the year than at the start. With 98% odds in their favor (assuming that they knew the trend), it becomes difficult to conceive of investors showing net losses at this time. Yet there is no doubt that this has happened in a great many cases. It is probably that these individuals came in late on the swing, then bought on "tips" and hunches, or on the advice of ignorant but well-meaning friends.

This writer, having been fully invested through the entire 1957-58 advance, elected to take profits in January of 1959, when things looked less than inviting. Because of the uncorrected 200 point rise since October, 1957, and because of the third phase characteristic visible all about us, I have decided to keep about 40% of my capital in cash and the other 60% in my original holdings (some of them are 8 or 9 years old) or in "cats-and-dogs." The latter were purchased during the last year or so in the expectation of a final explosion in cheap stocks. This personal accounting is not meant to be a recommendation or an example to be followed. Each investor or institution has different objectives, different needs, and different restrictions.

THE GREAT REACTION OF 1957. I have received many requests for a study covering the secondary reaction of July-October, 1957. Because of its recentness and severity, it has made a lasting impression on the minds of a great many people. My own reason for reviewing the '57 reaction, however, is because of its amazing resemblance (in its early stages) to the January-February, 1959 decline. A comparison of these two formations gives us graphic evidence of one point that I have often made in these Letters; that is the impossibility of predicting whether a bearish formation will result in a full secondary reaction, a decline, or a mere period of hesitancy.

Starting with the 1957 reaction, both averages hit their highs at A, but note that volume was receding as these highs were hit, a clear danger signal. The two averages then declined to B, and volume diminished on the decline as well. Another rally followed, and here rails hit a new high at C, but industrials formed a tiny "line" (B-C, obviously a line of distribution); they had refused to confirm the new rail highs.



Volume was still decreasing, and Dow Theorists should have been holding their breaths here. On the next dip (C-D), the B lows of the preceding decline were abruptly violated, and the first downward zig-zag formation was completed. An insignificant advance (D-E) followed as volume remained low; then the two averages broke the second decline lows at D, whereupon stocks headed down in earnest. As all readers know, a 100 point drop followed as the market went into a secondary reaction which predicted the worst recession since the bull market began in 1949.

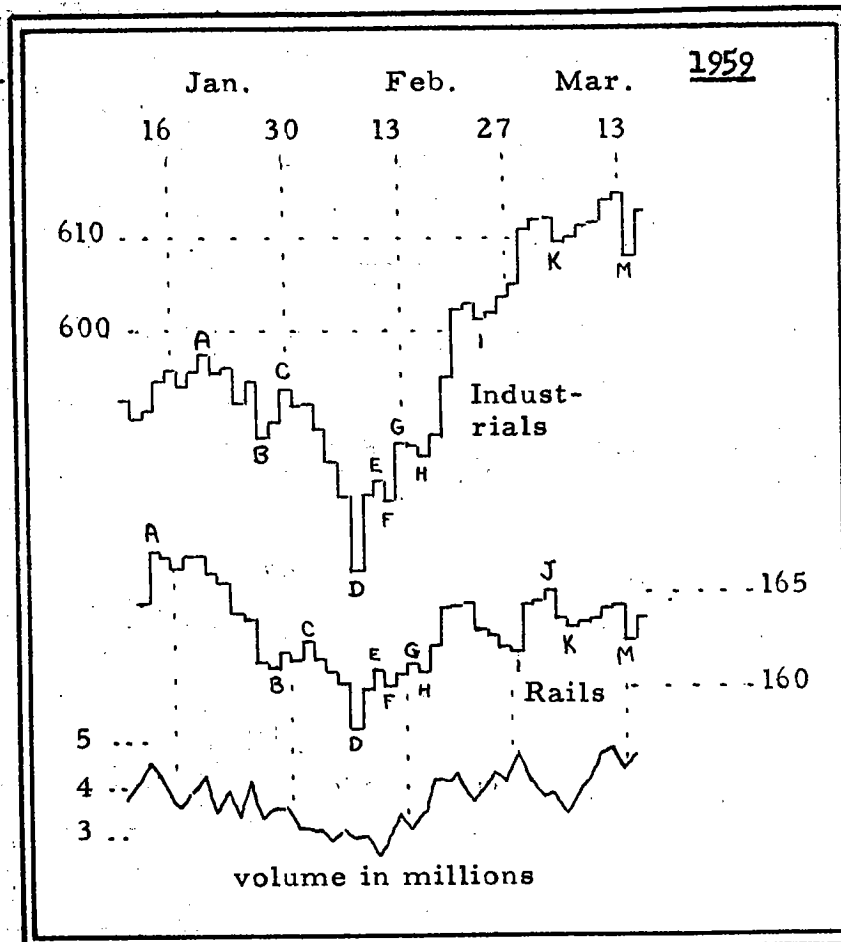
If we compare the whole A-D decline of last January-February, 1959 (see current chart) to the 1957 formation, it becomes obvious that the two charts are very similar; volume indications were almost identical. Last January volume was trending lower as the highs at A were hit. Then a downward zig-zag was formed as the B lows of the first decline were violated on generally low volume. But at the lows of D the market held firm; this spot (unlike the D point of 1957) proved to be the final bottom. At the buy-spots of F and H, volume dried up dramatically, and it became readily apparent that the D lows would not be broken.

These two charts should be studied carefully and at length. Readers may now see why I was worried last January. Based on the implications of the averages, I had every right to be worried, and I do not believe any Dow Theorists could have ignored either of these formations. The comparison of the two charts illustrated the extreme difficulty of forecasting secondary reactions, and this is why I have so often stated that the most treacherous area with which Dow Theorists have to contend is the point, following a long advance, where the averages begin flashing danger signals. Dow Theory traders often sell out at these spots and willingly pay the cost of "insurance" (commissions and taxes) against a possible secondary reaction.

Those investors who consistently "ride out" the type of formations pictured here will be subject to many severe losses and sleepless nights. Although I can understand a long-term investor's desire to play only the primary trend while ignoring reactions, such an investor must be willing to accept the consequences of his policy. This can mean sitting out severe reactions (such as the 1957 affair) with the resultant loss of a substantial percentage of paper profits.

PRICE MOVEMENTS. Since my last Letter the market as measured by the D-J averages has been fluctuating within a rather limited area. Volume has tended to expand on the rallies and diminish on the declines. If one takes the price movements from the beginning of March to the present, the general appearance of the averages suggests a "line." Rails in particular have been moving within a narrow range which began in mid-February and has extended to the present. The rail high established last January at point A (167.38) continues to be the prime objective for the carriers, and a bettering of this point would be a long awaited bullish signal.

The best indication we have to go on at present is volume. So far any selling (such as Monday's sharp drop) has not brought out any significant pressure; this is always a hopeful sign. I feel



that the longer the two averages hold above their lows at D (indust., 574.46; rails, 157.94) the better the chances of an eventual rail confirmation and broad upward sweep. In a bull market the trend of values is to increase with the passage of time. For this reason the majority of lines are broken upside in bull markets. I believe, based on past precedent and present volume indications, that the next major move will be up.

BUY-SPOTS. The following is reprinted from a Letter of last December 19, 1958. Older readers will have to pardon these repetitions, but I feel that new subscribers must have certain information in order to operate properly. One of the most important areas of the Dow Theory is that which deals with correct timing of purchases...

New students of the Dow Theory should practice the art of picking buy-spots. There is a widespread misconception that the Dow Theory implies buying only after both averages have bettered previous highs, and after bullish signals have been given. Nothing could be further from the truth. Hamilton and Rhea repeatedly outlined the following formation as a buying area. Following a normal decline or reaction, an advance will take place. After this advance, if on the next decline one or both averages hold above their previous lows and volume diminishes as the lows are approached, stocks should be purchased. The absence of volume on the second decline denotes a lack of selling pressure, and is almost always a bullish indication. Then after making our purchases, if the two averages advance over their old highs this merely corroborates our earlier bullish inferences, and points out that we were correct in buying near the lows. If, for some reason, we were mistaken and both lows are violated after we have bought stocks, we can sell and pay the price of "insurance" with but slight losses. Most buy-spots work out well, however, and they should be watched for on each decline.

STOCKS. Many of the stocks recently suggested have outperformed the market despite the hesitancy in the averages. Investors are becoming increasingly eager as they watch stocks such as BECKMAN, HOFFMAN ELECTRONICS, AMERICAN CABLE, and INT. TEL. & TEL. explode skyward. Significantly, Barron's Low Priced Stock Index jumped 16 points to a new high (247.7) during the week ending March 16. One year ago this Index stood at 123.3!

I do not consider the present area a buy-spot. Readers were given the points F and H as buy areas, and newcomers will have to make purchases at these highs at their own risk. If the minor lows of last Monday (M on chart) are approached on low volume and one or both averages hold above the M points (indust., 607.88; rails, 162.82) I suppose we might call it a buy spot even though it comes at a pretty high level on the industrials.

The following look bullish on my charts: AMERICAN POTASH, OLIN MATHIESON, DOW CHEMICAL, GENERAL TIRE (if it goes to 72 on volume), STANDARD COIL (if it hits 21 on volume), CAPITAL AIRLINES, EASTERN AIRLINES, AMERICAN AIRLINES. Many readers bought AVCO as suggested in the 7-9 area. I would continue to hold this stock. HEYDEN NEWPORT looks like an interesting number if it hits 18 on volume.
(written March 18, 11:00 P.M.)

Thirty Stocks Used in Dow Jones Industrial Averages are:

Allied Chemical	General Electric	Procter & Gamble
Amer Can	General Foods	Sears Roebuck
Am Smelt & Ref	General Motors	Std Oil of Cal
Amer Tel & Tel	Goodyear	Std Oil of N.J.
Am Tobacco	Inter Harvester	Texas Co.
Bethlehem Steel	Inter Nickel	Union Carbide
Chrysler	Inter Paper	United Aircraft
Corn Products	Johns Manville	U.S. Steel
Du Pont	Nat'l Distillers	Westinghouse El
Eastman Kodak	Nat'l Steel	Woolworth

Twenty Railroad Stocks Used are:

Atchafson	Erie	NY NH & H
Atl Coast Line	Great North Ry	Norfolk & West'n
Baltimore & Ohio	Illinois Central	Pennsylvania
Canadian Pacific	Kansas City So	Southern Pacific
Ches & Ohio	Louisv & Nash	Southern Railway
Chi Rk Is & Pac.	N Y Central	Union Pacific
Del & Hudson	N Y C & St L	
